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NEW ADVANCE FOREX RECEIPTS REGULATIONS ADOPTED

Key Points:

- ***New regulations lock out speculative foreign capital inflows***
- ***Measures ease pressure on “overvalued” currency***

Effective June 1, 2005, the State Administration of Foreign Exchange adopted the Notice on Regulating the Administration of Export Advance Payments and Entrepôt Foreign Exchange Earnings which is designed to improve and enhance the existing framework for the verification of commercial trade transactions with a view to preventing a “run” on the Renminbi through massive inflows of speculative foreign capital. Speculative foreign capital inflows have long been a feature of economies believed to

have overvalued currencies; such has been the situation in China now for quite some time.

Adopted with the intention of eliminating speculative/non-trade-related capital inflows, the Notice requires that foreign currency inflows in excess of US\$200,000 that are claimed to fall into any one of three commercial transaction categories must be investigated to ensure the veracity of such claims: (i) entrepôt trade payments; (ii) advance forex payments for goods to be exported; and (iii) overseas remittances to a China-based forex bank account. Pending verification by the receiving bank that the forex remittance pertains to a genuine trade transaction, the bank is required to place the forex funds in a “future settlement account.” Such sums are not counted as comprising received forex funds until the verification process has been successfully completed. The Notice places the burden upon the receiver of the forex funds to present the receiving bank with documentation evidencing the legitimacy

of the transaction. For example, the Notice requires that a person in receipt of forex funds for entrepôt trade to first present the bank with the original Foreign Exchange Inspection Verification and Cancellation Application for Export Goods and thereafter follow up by presenting the original Customs (Export) Declaration evidencing the actual export of the goods. While the Renminbi was revalued by some 2% in July 2005, it is clear that the perception still persists that the Renminbi is overvalued. In such an environment, it is likely that the Notice will play a significant part in preventing speculative foreign capital inflows to China.

– Diarmuid O'Brien

SAFE PUBLISHES A COMPREHENSIVE LIST OF ITS ADMINISTRATIVE LICENSE ITEMS

Key Point:

- ***Total of 39 administrative licensing items and 173 sub-items, as well as detailed information, included in the list***
- ***Only items in the list are administrative licensing items; local SAFE branches or offices cannot add or delete any items in the list***

On June 2, 2005, SAFE issued the Circular Regarding Publishing the SAFE Administrative Licensing Items List (the "Circular"), which unifies and includes all currently valid administrative licensing items of SAFE. The Circular represents an additional step SAFE has taken to implement the

PRC Administrative Licensing Law and provides more certainty to foreign exchange procedures.

In recent years, with the promulgation of the PRC Administrative Licensing Law and the reform of the administrative licensing system in China, SAFE has reviewed and revised its administrative licensing procedures on a number of occasions. In total, 34 administrative licensing items have been canceled.

The remaining 39 administrative licensing items are compiled in the Circular and are divided into 173 categories. The Circular provides detailed information about the categories, including description, statutory base, required approval time and required application documents. No new administrative licensing procedures were added to the list under the Circular.

According to the Circular, only items in the list can be classified as administrative licensing items. Local SAFE branches or offices do not have the authority to add or delete any items in the Circular.

The Circular further provides that local branches or offices shall strictly follow the approval requirements in the Circular, which require the local agencies to make a decision in a fixed period (generally 20 days) and stipulate that they cannot request additional application documents to those in the list. The Circular also provides that if the situation allows, SAFE shall render a decision immediately when all the application documents are complete and ready.

However, the Circular is not inclusive of all administrative licensing items. According to the Circular, local SAFE offices that encounter any

matter that is not in the Circular's list but may constitute an administrative licensing item should report to headquarters in Beijing.

– Guojun Ye

SAT TIGHTENS SCRUTINY OF FOREIGN TAX PAYMENTS

Key Points:

- ***Deters tax evasion***
- ***Helps authorities implement Rules on Assessment of Tax Payment***

The PRC State Administration of Taxation (“SAT”) recently issued a notice, the Notice Concerning Income Tax Assessment for FIEs and Foreign Companies (the “Notice”), that sets guidelines on how to examine income tax payments by foreign-invested enterprises and foreign companies. The purpose of the notice is to deter tax evasion and to help tax authorities implement SAT's March 31 Rules on Assessment of Tax Payment. These rules provide tax authorities with analytical methods and formulas for evaluating the payments of corporate taxpayers in China.

According to the rules, tax inspectors may use different methodologies to evaluate the tax payment compliance of domestic companies and FIEs. For both types of companies, the rules list tax payment scenarios that tax authorities must study for possible irregularities. The rules require officials to carefully review transactions between one FIE and its associated companies. In addition, the authorities will first assess tax payments by FIEs that are large,

claim losses, enjoy tax preferences, make extremely low tax payments, operate in multiple regions in China, and employ transfer pricing. The Notice additionally authorizes the higher tax bureau to become involved in complex and large FIEs' tax matters and requires all local tax bureaus to report the tax assessment of local FIEs to the central bureau at the end of each year.

The Notice state that it was issued in response to a perceived tax evasion problem involving FIEs and a clear sign of the PRC government's decision to combat the alleged problem. Although today there are more than 400,000 FIEs China, 60% claim losses and the average loss rate is up to 51-55%, in the total amount of 120 billion RMB a year, according to an official of the central tax bureau. Pursuant to the Notice, the Tax authorities will scrutinize various arrangements that may create opportunities for tax evasion such as the payment of service fees, management fees, licensing fees, fees paid for technology agreements and interest payments of shareholders' loans.

In the past 20 years, China's tax bureaus did not pay a great deal of attention to tax evasion, as official policy was to attract as much foreign investment as possible in the shortest period of time. However, in the past year, the government has begun to realize the seriousness of the problem and decided to take action. The so-called “first tax evasion case” in China was decided last year in Guangzhou, with a administrative order requiring against Procter & Gamble to pay US\$80 million in deferred income taxes and late fees. FIEs in China need to be aware of the government's evolving policy and exercise

caution with internal transaction to avoid tax exposure. — *Lindsay Zhu*

TAX REDUCED ON INDIVIDUAL INVESTORS' DIVIDEND INCOME

Key Point:

- *Enhances equity market*

As one of several measures intended to enhance the equity market, on June 13 2005, the Ministry of Finance and the State Tax Bureau jointly issued a Circular (the "Circular") regarding imposition of income tax on individual investors' dividend income.

According to the Circular, individual investors' dividend income accruing from tradable shares issued by listed companies is reduced by 50% effective from June 13, 2005. Article 3 of the Individual Income Tax Law of the People's Republic of China provides in part, "income derived from...dividends or bonuses...shall be taxed at a proportional tax rate of 20%." The Circular reduces this tax rate on individual dividend income to 10%.

The Circular does not cover institutional investors. The institutional investors have always been shielded from the dividend income tax by accounting rules that allowed them to offset dividend income directly against the investment cost. —*Zhang Wei*

Presentations, Articles and Publications

James Zimmerman, *China Law Deskbook, Second Edition (2005): A Legal Guide for Foreign-Invested Enterprises*. More information is available on ABA's Web site:

<http://www.abanet.org/abastore/index.cfm?section=main&fm=Product.AddToCart&pid=5210139>.

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